No. 15038

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRANK M. CHICHESTER, Trustee, in Bankruptcy of Estate of S. A. WILLEN COMPANY, a corporation, bankrupt,

Appellant,

vs.

UNION BANK & TRUST CO. OF LOS ANGELES,

Appellee.

APPELLANT'S OPENING BRIEF.

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Statement of Jurisdiction.

This is an appeal from a decision of the District Court reversing, on a Petition for Review, an Order of the Referee in Bankruptcy. Jurisdiction of the District Court existed under Section 67(c), Title 11, U. S. C. A.

Jurisdiction of this Court on appeal exists under Section 47 of Title 11, U. S. C. A.

Statement of Case.

This appeal is taken from an order of the District Court in favor of the appellee, the Union Bank & Trust Company of Los Angeles (hereinafter referred to for convenience as "Bank"), reversing an order of the Referee holding invalid, as against creditors and the Trustee in Bankruptcy, appellant herein, a chattel mortgage exe-

cuted by the S. A. Willen Company (hereinafter referred to for convenience as "Willen"). The nature of this dispute can best be set forth by a summary of the events leading to this appeal.

On February 4, 1953, Willen, a corporation, executed its note and chattel mortgage to the Bank as mortgagee. On February 4, 1953, the note and chattel mortgage securing its payment, were manually delivered and deposited by Willen into an escrow set up with the Bank. The Bank thereupon and thereafter, until February 20, 1953, was both escrow-holder and mortgagee. On February 4, 1953, as a part of the same transaction, Willen executed a Notice of Intention to Mortgage Chattels and the said Notice of Intention to Mortgage Chattels was recorded by the Bank on February 5, 1953, in the office of the County Recorder of the County of Los Angeles, State of California. The said Notice of Intention to Mortgage Chattels provided that the executed mortgage would be delivered and the consideration therefor paid on February 20, 1953. The Notice of Intended Mortgage provided for the mortgage of the machinery and equipment of a certain manufacturing business known as S. A. Willen Company. [Appellee's Ex. 4; R. p. 73.]

On February 20, 1953, the escrow closed and on that date the Bank recorded the chattel mortgage in the Office of the County Recorder. On February 24, 1953, the money constituting the consideration for the note and chattel mortgage securing its payment, was paid by the Bank to Willen.

On July 29, 1954, Willen filed its voluntary petition in bankruptcy in the District Court for the Southern District of California, Central Division.

Pursuant to a stipulation, on November 16, 1954, the Referee in Bankruptcy ordered that Frank M. Chichester as Trustee of the bankrupt estate be permitted and directed to sell and dispose of the machinery and equipment covered by the chattel mortgage, free and clear of and from the lien of the chattel mortgage and hold the proceeds subject to the lien of the said mortgage. Thereafter, the Trustee did, pursuant to said order, sell said machinery and equipment, retaining from the proceeds therefrom the sum of $15,991.68, being the amount of the obligation yet secured by the chattel mortgage.

On February 15, 1955, the Bank filed its Petition for Reclamation, asking that an order be made and entered declaring that the note and chattel mortgage held by the Bank to be a valid note and chattel mortgage. It was stipulated that creditors existing prior to February 4, 1953, were still creditors at the time of bankruptcy.

Thereafter, on June 9, 1955, the Referee held that, inasmuch as the note and chattel mortgage had been delivered to the Bank as both mortgagee and escrow holder, the chattel mortgage was delivered absolutely on February 4, 1953, and that the delay of sixteen days between February 4, 1953 and February 20, 1953, the date of the recordation of the chattel mortgage, was so unreasonable as to render the chattel mortgage invalid

as against the Trustee and creditors. Thereafter, on August 1, 1955, the Referee made and entered his order declaring said chattel mortgage to be invalid and of no force and effect as to Frank M. Chichester, the Trustee in Bankruptcy, and as to creditors of the bankrupt estate.

Thereafter, on August 11, 1955, the Bank filed its Petition for Review of the Referee's Order. The Judge of the District Court, by his Memorandum Opinion dated December 15, 1955, reversed the order of the Referee, and held that the chattel mortgage had been delivered conditionally to the Bank on February 4, 1953, and that the mortgage did not come into existence until February 20, 1953, at which time the money was purportedly paid, and the mortgage was recorded.

Thereafter, on January 18, 1956, the Trustee in Bankruptcy filed a notice of appeal to the Court of Appeals.

Specification of Errors.

1. The Court erred in refusing to pass upon the question of the validity of the escrow wherein the mortgagee was also the escrow holder. [R. p. 70.]

2. The Court erred in refusing to hold that the delivery of the mortgage to the mortgagee-escrow holder was an absolute delivery to the mortgagee on February 4, 1953. [R. p. 70.]

3. The Court erred in failing to consider the effect on the rights of creditors of the execution and deposit of a mortgage in an ineffective escrow held by the mortgagee as escrow holder. [R. p. 70.]

4. The Court erred in finding that according to the terms of the escrow contract the amount of the loan was paid to the bankrupt on February 20, 1953, when the record clearly shows that the money was actually paid over to the bankrupt on February 24, 1953. [R. p. 71.]

5. The Court erred in holding that the mortgage came into existence on February 20, 1953, when the bank paid over the money, while the record clearly shows that the bank did not pay over the money until February 24, 1953. [R. pp. 70-71.]

6. The Court erred in failing to consider the effect on the rights of creditors, of the recordation of the mortgage before the debt, for which the mortgage is security, came into existence. [R. p. 71.]

7. The Court erred in failing to consider the validity of the mortgage which was recorded four (4) days prior to the time that the money was paid over to the debtor. [R. p. 71.]

8. The Court erred in failing to consider the effect on the rights of creditors, of the delay of sixteen days between the execution and recordation of the mortgage. [R. p. 71.]

Summary of Argument.

It is appellant's contention that the following is determinative in this appeal:

1. Willen's execution as mortgagor, on February 4, 1953, of its promissory note and chattel mortgage, and its deposit of the same in escrow with the Bank as both

mortgagee and escrow holder resulted in an invalid escrow, inasmuch as the Bank could not properly act as both mortgagee and escrow holder.

2. The deposit of the chattel mortgage by Willen on February 4, 1953, in escrow with the Bank as mortgagee —escrow holder constituted an absolute delivery of the chattel mortgage to the Bank on February 4, 1953.

3. Inasmuch as the chattel mortgage was absolutely delivered to the Bank on February 4, 1953, the delay of sixteen (16) days to February 20, 1953, at which time the chattel mortgage was recorded in the Office of the County Recorder, was unreasonable, and rendered the chattel mortgage invalid as to creditors in existence on February 4, 1953, who were also creditors at the time of bankruptcy.

4. Assuming, however, that the invalid escrow can be disregarded and it is held that a conditional delivery resulted therefrom, the chattel mortgage must still be held invalid as to creditors. The event upon which the delivery to the Bank was conditioned was the passing of the consideration from the Bank to Willen. The evidence clearly shows that the consideration did not pass until February 24, 1953, four (4) days *after* the Bank had recorded the mortgage. Inasmuch as a mortgage has no existence apart from the debt, and inasmuch as the debt, and, therefore, the mortgage, did not come into existence until *after* the recordation on February 20, 1953, the recordation was a nullity and did not constitute notice to creditors.

ARGUMENT.

I.

The Bank Could Not Properly Act as Both Mortgagee and Escrow Holder. As Mortgagee the Bank Was a Party Directly Interested in the Mortgage Transaction and Thereby Was Precluded From Acting as Escrow Holder in the Same Transaction.

The Referee found that on February 4, 1953, Willen, as mortgagor, executed his note and chattel mortgage in favor of the Bank, and on that date "manually delivered and deposited" said note and chattel mortgage "into an escrow" set up with Bank, and that the Bank "until February 20, 1953, was both the mortgagee and escrow holder." [R. pp. 25-26.] The Referee concluded from these facts that the Bank could not properly act as its own escrow holder.

The District Court, however, in its decision felt it unnecessary to pass upon the question of validity of the escrow. [R. p. 39.]

To quote from the District Court's memorandum:

> "This court feels it is not necessary in this case to pass upon the question of the validity of the escrow." [R. p. 39.]

It is the contention of the appellant, however, that the question of the validity of the escrow must be decided before the validity of the chattel mortgage may be determined. The validity of the chattel mortgage is dependent on the validity of its delivery and the validity of the

delivery of the chattel mortgage in turn is dependent on the validity of the escrow.

The authorities all agree that a party to a transaction cannot also act as escrow holder:

> "It is essential to an escrow that the instrument be delivered to a stranger or third person. The phrase 'stranger' or 'third person,' as used in the definition of an escrow, means a stranger to the instrument, not a party to it, or a person so free from any personal or legal identity with the parties to the instrument, as to leave him free to discharge his duty as a depository to both parties without involving a breach of duty to either."
>
> 19 *Am. Jur.* 431.

> "And he must be a stranger to the transaction which is the subject matter of the escrow."
>
> 18 *Cal. Jur.* 2d 324.

In the recent 1956 California case of *Roberts v. Carter,* 140 A. C. A. 387, at page 389, the Court says in discussing the functions of an escrow holder:

> "He must be a stranger to the transaction which is the subject matter of the escrow."

The law in California respecting the deposit of instruments in escrow is set forth in the Civil Code:

> *"Delivery in escrow.* A grant may be deposited by the grantor with a third person, to be delivered on performance of a condition, and, on delivery by the depositary, it will take effect. *While in the possession of the third person,* and subject to condition, it is called an escrow." (Emphasis added.)
>
> *Civ. Code,* Sec. 1057.

The above Code Section is a codification of the Common Law rule that an escrow required that the subject matter of the transaction be placed in possession of a third party—a stranger to the transaction—pending the performance of the condition for which the escrow was created.

The District Court in its memorandum decision seems to beg the question as to whether or not a chattel mortgage is proper subject matter to comply with Section 1057 of the California Civil Code, *supra.*

Section 1057 of the Civil Code refers to a grant while Section 2920 of the Civil Code defines a mortgage as a contract:

> "Mortgage is a contract by which specific property is hypothecated for the performance of an act, without the necessity of a change of possession."
>
> *Civ. Code,* Sec. 2920.

While a mortgage is a contract, it is still proper subject matter for an escrow.

In 10 *Cal. Jur.* 577, it is stated:

> "The term 'grant' as used in the definition of an escrow given by the Civil Code is comprehensive enough to include instruments other than deeds. And it follows that contracts, notes, options . . . and other personal property may all be subject of delivery in escrow."

See, also,

Carr v. Howell, 154 Cal. 372.

In *Sousa v. First California Co.,* 101 Cal. App. 2d 533 at 539, citing Civil Code, Section 1057, and involving a check deposited in escrow, the Court states:

> "An instrument is 'deposited in escrow' when in accordance with an agreement to that effect *it is deposited with a third person* to be delivered to the other party to the agreement on the performance of a specified condition." (Emphasis added.)

The Court, in *Rockefeller v. Smith,* 104 Cal. App. 544 at 547, states:

> "The term 'grant' as used in the definition of an escrow given by the Civil Code is comprehensive enough to include instruments other than deeds."

The authorities in California agree that a chattel mortgage, although a contract, falls within the provisions of Section 1057 of the Civil Code of California and must be deposited with a third person, a stranger to the transaction, to constitute a valid escrow. It must therefore be concluded from the authorities: (Appellant was unable to find any authority to enable a bank in California to act as escrow holder in a transaction in which it is a party):

(a) That the delivery to the bank was intended as a delivery in escrow;

(b) That the intended escrow holder was a party to the transaction and not a stranger to the transaction so as to qualify as such holder;

(c) That the escrow was invalid and ineffective.

II.

The Delivery and Deposit by the Mortgagor of an Executed Note and Chattel Mortgage With the Mortgagee Bank Acting as Escrow-holder for the Transaction on February 4, 1953, Constituted an Absolute Delivery on That Date.

It is clear in this case that delivery to the bank of the chattel mortgage was intended as a delivery in escrow. [R. pp. 25-26, 20, 38.] The intended escrow holder was a party to the transaction and therefore the escrow was void and ineffective as set forth in Argument I.

The question now presented is: What is the effect of the delivery and deposit of a chattel mortgage with the mortgagee as escrow holder? It would appear that if the escrow itself is void, then there must be absolute delivery on the date of execution, or, in the alternative, there is no delivery, with the result that the mortgage never became effective.

Application of California Civil Code, Sections 1056, 1057 and 1053, and the law as stated by the California Appellate Court in *Rockefeller v. Smith, supra,* leads to only one conclusion, which is the conclusion reached by the Referee, that the delivery to the Bank, acting as both mortgagee and escrow-holder, was absolute and took effect on February 4, 1953:

> "The infallible test of delivery is the fact that the grantor has divested himself of all dominion and control over the conveyance."
>
> *Jones on Chattel Mortgages,* Vol. 1, p. 190, sec. 112.

Section 1056, California Civil Code reads:

> *"Delivery to grantee is necessarily absolute.* A grant cannot be delivered to the grantee conditionally. Delivery to him, or to his agent as such, is necessarily absolute, and the instrument takes effect thereupon, discharged of any condition on which the delivery was made."

Section 1057, California Civil Code, reads:

> *"Delivery in escrow.* A grant may be deposited by the grantor with a third person, to be delivered on performance of a condition, and, on delivery by the depositary, it will take effect. While in the possession of the third person, and subject to condition, it is called an escrow."

Section 1053, California Civil Code reads:

> "A transfer in writing is called a grant, or conveyance, or bill of sale. The term 'grant,' in this and the next two articles, includes all these instruments, unless it is specially applied to real property."

California Civil Code Sections 1056, 1057 and 1053, leave no doubt that a grant cannot be delivered to the grantee conditionally, the delivery to the grantee is absolute.

The Referee in his Decision [R. p. 22] states:

> "I am aware of the definition of the term 'grant' in sec. 1053, Civil Code. I conclude that chattel mortgages, which transfer in writing liens on personal property, come within this definition. *Rockefeller v. Smith,* 104 Cal. App. 544 at 547. See also sec. 1627, Civil Code. Even though chattel mortgages are excluded from the definition, the general

principles of law concerning escrows would lead to the same conclusions that I have reached. 19 Am. Jur. 431, *supra.*"

Section 1627, California Civil Code reads:

"The provisions of the chapter on transfers in general, concerning the delivery of grants, absolute and conditional, apply to all written contracts."

Section 2920, California Civil Code reads:

"*Mortgage, what.* Mortgage is a contract by which specific property is hypothecated for the performance of an act, without the necessity of a change of possession."

Section 1626 of the California Civil Code reads:

"*Contract in writing, takes effect when.* A contract in writing takes effect upon its delivery to the party in whose favor it is made, or to his agent."

The Referee, in his Memorandum Decision, takes into consideration California Civil Code, Sections 1053, 1056, 1057 and 1627, and the law as stated in *Rockefeller v. Smith, supra,* in arriving at his conclusion:

"It is clear that in this case the delivery to the petitioner was intended as a delivery in escrow. The intended escrow holder was a party to the transaction. Therefore, under the law as I have found it to be, the delivery to the petitioner and mortgagee was absolute and took effect on February 4, 1953." [R. p. 22.]

A grant is defined by Civil Code, Section 1053, as a transfer in writing. The question as to whether a chattel mortgage comes within that definition is answered by

Civil Code, Section 1066, which says that grants are to be interpreted in like manner with contracts in general, and by Civil Code, Section 1627, which provides that Sections 1053, 1056 and 1066 apply to *all written contracts,* which necessarily include chattel mortgages.

The Referee in his Memorandum Decision quotes the case of *Rockefeller v. Smith, supra,* in arriving at his conclusion that contracts and grants come within the definition of the term "grant" in the California Civil Code. Appellant attaches importance to this case because it quotes and explains the California Civil Code sections forming the basis of the Referee's decision.

California Civil Code, Sections 1626, 1053 and 1627, are cited and quoted in *Rockefeller v. Smith,* 104 Cal. App. 544, 547-548, as follows:

> " 'A contract in writing takes effect upon its delivery to the party in whose favor it is made, or to his agent. (Civ. Code, sec. 1626.) Delivery of the instrument is the final act essential to its consummation as an obligation' . . .
>
> " 'A transfer in writing is called a grant, or conveyance or bill of sale. The term "grant" in this and the next two articles includes all these instruments, unless it is specially applied to real property.' (Civ. Code, sec. 1053.)
>
> " 'The term "grant" as used in the definition of an escrow given by the Civil Code as comprehensive enough to include instruments other than deeds. . . .
>
> " 'The provisions of the chapter on transfers in general, *concerning the delivery of* grants, absolute and conditional, apply to all written contracts. (Civ. Code, sec. 1627.) . . .

" 'A grant may be deposited by the grantor with a third person, to be delivered on performance of a condition, and, on delivery by the depositary, it will take effect. While in the possession of the third person, and subject to condition, it is called an escrow.' (Civ. Code, sec. 1057.)

" 'Though a grant be not actually delivered into the possession of the grantee, it is yet to be deemed constructively delivered in the following cases:

" '1. Where the instrument is, by the agreement of the parties at the time of execution, understood to be delivered, and under such circumstances that the grantee is entitled to immediate delivery; or,

" '2. Where it is delivered to a stranger for the benefit of the grantee, and his assent is shown, or may be presented.' (Civ. Code, sec. 1059.)"

In 10 *Cal. Jur.,* at page 577:

"The term 'grant' as used in the definition of an *escrow* given by the Civil Code is comprehensive enough to include instruments other than deeds. And it follows that contracts, notes . . . and other personal property may all be the subject of delivery in escrow."

In 18 *Cal. Jur.* 2d 303, 304:

"The Civil Code provides . . . that a grant deposited by the grantor with a third person, to be delivered on the performance of a condition and to take effect on delivery by the depositary, is called an escrow while in the possession of the third person, and that in this connection the term 'grant' embraces transfers in writing irrespective of whether they refer to real, or to personal property."

The authority as stated in the California Civil Code Sections as well as case law is that chattel mortgages come within the definition of Civil Code, Section 1053.

In this case the grantor intended to deliver the chattel mortgage to the Bank in escrow. The Bank was a party to the escrow. Therefore, as held by the Referee, the delivery to the Bank as mortgagee was absolute and took effect on February 4, 1953.

The only alternative conclusion would be that there was no delivery. Such a conclusion that there was no delivery would lead to the further conclusion that the chattel mortgage never became effective. In *Hotaling v. Hotaling,* 193 Cal. 368, the Court held that the rule of Section 1056, Civil Code, does not come into effect until there has been a delivery, and that that delivery does not depend on the "manual tradition" of the document, but that by change of possession of the document, the grantor must have intended to divest himself of title. In the absence of that intent there was no delivery. In this case the intention of the mortgagor was to deliver the chattel mortgage into a valid escrow. The escrow was invalid and ineffective and therefore delivery in an invalid escrow would constitute no delivery at all. To quote the Referee's Memorandum [R. p. 21]:

> "In the instant case the petitioner cannot deny delivery, otherwise it would be completely out of court."

Therefore, it must be concluded, as was held by the Referee in his Memorandum Decision, that delivery to the Bank as mortgagee was absolute and took effect on February 4, 1953.

III.

A Delay of Sixteen Days Between the Execution and Delivery of a Chattel Mortgage and the Recording Thereof Is so Unreasonable a Delay as to Render the Mortgage Void as Against Creditors.

The appellant contends, as argued above, that the chattel mortgage was delivered to the bank on February 4th and that sixteen days' delay in its recordation, on February 20th, was so unreasonable as to make it ineffective as against creditors. In order for a mortgage to be valid as against creditors, it must be promptly recorded.

Civil Code, Section 2957, provides that a mortgage of personal property is void as against creditors of the mortgagor unless it is recorded in the office of the County Recorder.

While Section 2957 does not in itself provide for prompt recordation, the question as to what constitutes prompt recordation and the purpose thereof is discussed in a number of both California and Federal decisions.

In *Hopper v. Keyes,* 152 Cal. 488, beginning at 493, the court, in adopting and affirming the opinion of the District Court of Appeal, refers to an elaborate and signally able opinion by Justice Henshaw in *Ruggles v. Cannedy,* 127 Cal. 295, by saying:

> ". . . it is held that the recordation of the mortgage, having been designed by the statute as a substitute for and equivalent of immediate delivery and continued change of possession under the former system in vogue in this state, should be had immediately, or as near thereafter as practicable, upon the execution of the mortgage, in order to give notice to and bind third parties.

"It must be conceded that the authority for the creation of chattel mortgages in this state derives its force from the statutory provisions relating to the subject, and that all rights accruing by virtue of such mortgages can be protected and preserved only by fully meeting the requirements of the statute and strictly observing its provisions.

"That the recordation of the mortgage, under our present system, is one of the necessary and indispensable requisites to protect the rights of the mortgagee against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, is a self-evident proposition.

"It must be remembered, in general, that the policy of the law is against secret liens and charges to the injury of innocent purchasers or encumbrancers for value, and in particular, that mortgages of personal property are permitted only in certain specified cases, and then only upon the observance of certain formalities, designed to insure good faith, and to *give notice to the world* of the character of the transaction." (Emphasis added.)

Recordation should be had immediately upon execution, or as soon thereafter as practical, in order to give notice to and bind third parties; otherwise, the mortgage is void as to those persons (including creditors) enumerated in Section 2957 of the Civil Code.

In the matter of *In re Kessler,* decided by the District Court May 26, 1950, and reported in 90 Fed. Supp. 1012, the facts were similar to those here under consideration. There a delay of fourteen days in recording was held to be unreasonable (p. 1017).

In the *Kessler* case the chattel mortgage was acknowledged October 10. On October 11 the bank forwarded the mortgage to the Los Angeles County Recorder with a request that it be recorded and the bank billed for the recording fees. On October 14 the Recorder received the mortgage, placed it in a "hold" file, and mailed the bank a statement showing the fees required for recordation. The Recorder received in due course the bank's check dated October 23 as payment of the recording fees and on October 24, duly recorded the mortgage (p. 1014).

Prior to execution of the chattel mortgage there were creditors of the mortgagor whose claims still remained unpaid when on December 16, 1948, Kessler was adjudged bankrupt upon an involuntary petition filed November 30, 1948. At the filing of the petition the bankrupt was in actual or constructive possession of all property mentioned in the mortgage (p. 1014).

On January 3, 1949, the receiver, alleging that the bank's mortgage was invalid by reason of delayed recordation, petitioned the bankruptcy court for an order, requiring the bank to appear and show what lien, if any, it had upon the fixtures and equipment. A hearing was had and the Referee held the mortgage to be invalid (p. 1014).

The District Court, in confirming the order of the Referee, says at page 1017:

> "Section 2957 of California's Civil Code provides that a chattel mortgage is 'void as against creditors' if not recorded. Since recordation takes the place of 'immediate delivery' . . . required by Cal. Civil Code Section 3440, a mortgage must be recorded as soon after execution as practicable in order to be valid as against creditors. (Citing numerous cases.)
> . . .

"Unreasonable delay in recordation will void a mortgage even as against existing creditors. (Citing authority.)

"In the proceeding at bar, there were existing creditors of the mortgagor whose claims remained unpaid at the filing of the involuntary petition in bankruptcy. The bank delayed recordation of the mortgage for 14 days from the time of execution. . . . Such a delay is unreasonable. (Citing authority.) . . .

"The mortgage is invalid as against the receiver and general creditors because of . . . *unreasonable delay in recordation.*" (Emphasis added.)

The California Appellate Courts likewise have found that an unreasonable delay in recording will render a mortgage void as to creditors. And in *Williams v. Belling,* 76 Cal. App. 610, *it also was held that a delay of fourteen days was unreasonable.*

At pages 615 and 616 the Court there says:

"By section 2957 of the Civil Code it is provided that a mortgage of personal property is void as against creditors of the mortgagor . . . unless it is . . . recorded in like manner as grants of real property; and in *Ruggles v. Cannedy,* 127 Cal. 290, it is held that the recordation of a chattel mortgage, having been designed by the statute as a substitute for and the equivalent of the immediate delivery and continued change of possession formerly required in this state, should be had immediately or as soon thereafter as practical upon the execution thereof in order to give notice to and bind third parties.

"In the instant case it might fairly have been inferred that fourteen days had elapsed between the delivery of the mortgage and its recordation. Such delay, although not affecting its validity between the parties, . . . would, if not shown to be excusable, render the mortgage void as to creditors . . . whose claims were created during the interval. (Citing authorities.)"

The California authorities seem to be in accord in stating the principle that recordation is a substitute for delivery and change of possession, and that the recording of a mortgage is made by the Civil Code the equivalent of an immediate delivery and continued change of possession.

In discussing this principle the California Supreme Court in *Ruggles v. Cannedy,* 127 Cal. 290, asserting that an indefinitely delayed recordation will not take the place of an actual immediate delivery, says, beginning at page 296:

"One being designed as a substitute for the other, what is the condition, in the one case, if the property be not immediately delivered? Indisputably, the mortgage is void as to creditors. What, then, is the condition in the other case for the indefinite period during which there has been no recordation? *While recordation is lacking there is not only no equivalent for an immediate delivery,* but there is no delivery at all. Recordation itself is the substitute for delivery.

" 'A prompt recordation most obviously takes the place of an immediate delivery, and a delayed recordation of a tardy delivery.'

> ". . . A mortgage without immediate delivery would create a secret lien, admittedly void against creditors. Is a mortgage without immediate recordation any less a secret lien, or any less an evil to be avoided?" (Emphasis added.)

Ruggles v. Cannedy, supra, was decided by the Supreme Court of California in 1899. The United States Court of Appeals, in 1934, in *Swift v. Higgins,* 72 F. 2d 791, 795, declares that "the case of *Ruggles v. Cannedy* is still the law of California."

An unrecorded chattel mortgage, or one whose recordation has been unduly delayed, has been held to be void as to antecedent creditors and those who became creditors of the mortgagor during the period of time between execution and recordation.

> *Noyes v. Bank of Italy,* 206 Cal. 266, 272;
>
> *United Bank & Tr. Co. v. Powers,* 89 Cal. App. 690, 695.

It is therefore firmly established law both by decisions of the California Courts and the Federal Courts that a mortgage must be promptly recorded to be effective as against creditors.

In *Williams v. Belling,* 76 Cal. App. 610, a fourteen day delay was held to be unreasonable and the mortgage void as to creditors.

In re Kessler, 90 Fed. Supp. 1012 (S. D. Cal., 1950), a fourteen day delay was held to be unreasonable and the mortgage void as to creditors.

In *Summerville v. Kelliher,* 144 Cal. 155, a fifteen day delay was held not to invalidate the mortgage. This

case is clearly distinguishable from the instant case. Quoting from the *Summerville* case at page 157:

> "No rights were acquired, nor was any prejudice suffered by either Summerville,[1] or Herson[2] during the interval between the date of execution and the date of recording."

[1]Execution purchaser.
[2]Trustee in bankruptcy.

In the instant case there were rights of existing creditors as well as rights of intervening creditors accruing between date of execution and date of recordation.

In re Mercury Engineering, 68 Fed. Supp. 376 (S. D. Cal., 1946), a twenty-six day delay in recordation was held not to invalidate the mortgage. The *Mercury Engineering* case can be distinguished from the instant case in that the mortgage there was a *purchase money mortgage,* and therefore intervening creditors' rights were not affected.

To quote Judge Yankwich (p. 379):

> "California Courts do not seem to have been called upon to determine whether its provisions* apply to a purchase price chattel mortgage. But the Referee rightly concluded that it did not so apply upon no less an authority than the Circuit Court of Appeals for the Second Circuit, whose opinions upon a matter of this character interpreting a New York statute of identical import with ours command not only respect, but require following when no contrary ruling in our own Circuit appears."

*(Section 2957 of the Civil Code of California supplied.)

In *Citizens National Trust & Savings Bank v. Gardner,* 161 F. 2d 530 (C. C. A. 9), a purchase money mortgage

was also involved. Again there were no intervening creditors' rights. Quoting from the case at page 532:

> "The mortgage involved here was in the nature of a *purchase money mortgage* in that all of the proceeds of appellant's loan were used by the bankrupts to help *acquire new* assets." (Emphasis added.)

The Court in the *Citizens Bank* case (p. 533) quotes *In re Mercury Engineering Co.* as follows:

> "When we require notice before sale of stock in trade, we do so in order that the basis on which the prior credit has been secured be not dissipated without notice. But when the basis did not exist, but came into being through the very sale and incumbrance, the very foundation for the requirement is gone."

In the case of *In re Heningsen,* 291 Fed. 684, affirmed 297 Fed. 821, seven weeks was held to be not an unreasonable delay. That case can be distinguished in that the mortgage was in reality a substitution of an existing properly recorded mortgage and a change of existing security for the same creditor. The rights of creditors were in no way affected, as in the case at bar, between execution and recordation.

The court there said (297 Fed. 821, 822-823):

> "The function of the mortgage here attacked was merely to take the place of another mortgage which had been duly recorded for a long time. It is submitted that the actual filing of this mortgage was contemporaneous with the withdrawal or extinguishment of the *Weiss* mortgage. The mortgage at bar was no more than a change of security for the same creditor. Under such circumstances we think there was no unreasonable delay in filing."

From a study of the facts in this and the authorities cited, including statutes and State and Federal Court decisions, it must be concluded that a delay of sixteen days in recordation of the mortgage in question was unreasonable and the mortgage invalid as to creditors.

IV.

Assuming That the Chattel Mortgage Was Accepted Conditionally, Its Recordation on February 20th Was a Nullity Because the Debt for Which It Was Security Did Not Come Into Existence Until February 24th, Four Days After the Recordation.

While it is the contention of the appellant that the delivery of the chattel mortgage to the Bank as mortgagee and escrow holder was absolute and took effect on February 4, 1953, the result reached by the District Court would still be contrary to existing law regarding when a mortgage becomes effective as a mortgage.

The District Court in its Memorandum felt that it was unnecessary to pass upon the question of the validity of the escrow inasmuch as it concluded that the mortgage had been accepted conditionally. To quote from the Court's Opinion:

> "This court feels it is not necessary in this case to pass upon the question of the validity of the escrow. The act of the parties clearly indicates that the mortgage was accepted conditionally." [R. 39.]

It would appear that the Court in effect creates a conditional acceptance out of an invalid escrow. As set forth in I and II, an invalid escrow can lead to only two conclusions. There is either an absolute delivery or there is no delivery. The Court reaches its conclusion of a conditional acceptance by ignoring the escrow agreement, ignor-

ing the intentions of the parties to set up an escrow and ignoring the ineffectiveness of the escrow in law. While the appellant does not agree with this conclusion, it is felt that a discussion of the law regarding when a mortgage becomes effective is important.

It is well established that there cannot be a mortgage unless there is a debt or obligation which can be secured thereby.

In *Coon v. Shry,* 209 Cal. 612, the Court states the law, at page 615:

> "However, we have no hesitancy in holding, in accordance with well-settled principles, that the mortgage must stand or fall with the note. It is well settled in California that a mortgage or mortgage lien is a mere incident of the debt or obligation which it is given to secure. (Cal. Civ. Code, sec. 2909; 17 Cal. Jur. 710, sec. 27, and cases cited in footnote 11.) There cannot be a mortgage if there is no debt or other obligation to be secured. (*Holmes v. Warren,* 145 Cal. 457, 463 [78 Pac. 954]; *Todd v. Todd,* 164 Cal. 255, 258 [128 Pac. 413]; *Ahern v. McCarthy,* 107 Cal. 382, 386 [40 Pac. 482].) A mortgage in California has no existence independent of the thing secured by it. (*Estate of Fair,* 128 Cal. 607, 613 [61 Pac. 184]; *People v. Eastman,* 25 Cal. 601, 603.) As distinguished from the debt the mortgage has no determinate value. (*Nagle v. Macy,* 9 Cal. 426.)"

To quote from the District Court Memorandum Opinion:

> "It appears from the record that on February 4, 1953, the mortgagor executed the instruments and

> manually delivered them to the bank in an escrow agreement with the Union Bank and Trust Company of Los Angeles, the intention of the parties being that the money involved should not be paid to the bankrupt until February 20, 1953, at which time the transaction was to be completed, the escrow closed and the money passed." [R. p. 38.]

The Court held in this case that the mortgage did not come into existence until February 20, 1953, when the Bank paid over the money.

To quote the District Court's Memorandum Opinion:

> "It must be remembered that a chattel mortgage is merely security for a debt and if there is no debt there is no mortgage. In this case the mortgage did not come into existence until February 20, 1953, when the bank paid over the money and at that time the mortgage became a lien. (*Western Loan & Bldg. Co. v. Scheib,* 23 P. 2d 745; West's C. C. of Cal. and Annotations.)" [R. p. 40.]

The record shows, however, that the money was not paid over to Willen until February 24, 1953, and that there was no debt in existence on February 20, 1953, the date the chattel mortgage was recorded.

Appellee-petitioner's Exhibit No. 5, three ledger sheets of the *Union Bank and Trust Company re S. A. Willen Company* [R. 73] shows that the money was advanced on February 24, 1953.

Reporter's Transcript of proceedings, Wednesday, March 16, 1955, 10:00 A. M., before Honorable David B. Head, Referee in Bankruptcy, shows that the money was advanced on February 24, 1953. [R. p. 55.]

To quote from the Reporter's Transcript:

"The Referee: *When was the money paid over?*

Mr. Kornblum: On the 20th day of February.

The Referee: I was looking at the record here. I can't make it out.

Mr. Kornblum: Maybe I shouldn't have let Mr. Lukens go. But the money was paid at the time. There is an escrow and on the 20th day of February —in other words, the bank even took perhaps a longer time than the law even requires to give notice to creditors. Now, when the—

The Referee: It shows here apparently that the (13) money was advanced on '2-23-54,' and—

Mr. Kornblum: And they didn't have to advance it until 2-20.

The Referee: And *2-24*—

Mr. Kornblum: *That is 1953.* There seems to be some confusion in the pleadings. It is 1953.

The Referee: 2-24-53?

Mr. Kornblum: That is right." (Emphasis added.) [R. pp. 54-55.]

The record clearly shows, as pointed out, that the money was advanced to the mortgagor (Willen) on February 24, 1953, while the chattel mortgage which was the purported security therefor was recorded on February 20, 1953. There was no debt in existence on February 20, 1953. If, as the District Court held, the mortgage was accepted conditionally, the condition being the advancing of the money, it must follow therefore that the mortgage was *not capable* of recordation on February 20, 1953.

The law is well established in California that a mortgage has no existence independent of the thing secured.

Estate of Fair, 128 Cal. 607.

It is also well settled that a mortgage or mortgage lien is a mere incident of the debt or obligation which it is given to secure.

California Civil Code, Sec. 2909.

It must therefore be concluded that the recordation of the chattel mortgage on February 20, 1953, was totally ineffective and no lien could have arisen as there was no debt in existence for which it could be security.

Conclusion.

Upon the authorities cited and for the reasons set forth herein, appellant respectfully submits that the Referee's Decision should be reinstated and the Decision of the District Court should be reversed. It is submitted by appellant that the Bank, as a party to the mortgage transaction, could not properly act in an escrow both as mortgagee and escrow holder, and that the escrow therefore was invalid, and that the delivery of the mortgage to the Bank, as mortgagee and escrow holder, constituted an absolute delivery on the date of such delivery. Appellant further submits that the delay of sixteen days from the date of such absolute delivery to the date of recordation, was unreasonable as to the rights of creditors and that therefore the mortgage was invalid as to the Trustee and as to creditors.

Assuming, however, that a conditional acceptance can be construed from the ineffective escrow, appellant submits that the mortgage must still be held invalid as to creditors. The passage of the consideration and the creation of the debt was the condition upon which the acceptance was conditioned, and the debt for which the mortgage was security did not come into existence until four days after the recordation of the mortgage. Inasmuch as the law is well settled that the mortgage has no existence apart from the debt, the premature recordation was a nullity and rendered the mortgage invalid as to creditors.

Respectfully submitted,

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